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FEDERAL COMMUNICATIONS COMMISSION  
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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Implementation of Sections of the  
Cable Television Consumer Protection  
and Competition Act of 1992

Rate Regulation

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) MM Docket No. 92-266  
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**REPLY COMMENTS OF CONTINENTAL CABLEVISION, INC.  
ON THE THIRD NOTICE OF PROPOSED RULEMAKING**

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## SUMMARY

Continental submits that the Comments reflect widespread support for a modified version of the Commission's preferred approach to setting rates when channels are added or dropped. The Commission should apply that method only to the affected tier, and could better account for the needed margin on program additions by adding a margin to the programming adjustment. Channels added in conjunction with retransmission consent reflect additional programming which subscribers receive, and should be treated the same as any other channel. Otherwise, the Commission would be drawn into intractable editorial judgments, attempting to allow or disallow programming costs depending on the accidental affiliation of some cable networks -- such as MTV or ESPN -- with broadcasters who happen also to be carried.

The Commission should also accept Continental's proposal for the streamlined recovery of upgrade costs which enhance channel capacity. The proposal is a straightforward, easy to administer solution to the problem inherent in the benchmarks: failure to provide adequate compensation for the costs of plant upgrades needed to launch new programming. The proposal is simple and fairly apportions costs between regulated and nonregulated services, thus mooting the concerns raised by franchising authorities.

Continental's proposal--and indeed the entire construct of Commission rate regulation--will only work if the Commission exercises its responsibility to make and enforce all major ratemaking policy issues. The Commission has nondelegable statutory duties, and the breadth of vision and experience to balance various consumer, cable, and public policy concerns. By contrast, the principal franchising authorities traditionally have played the role of tough negotiators for franchise concessions, striving to avoid compensatory rate increases even for the most reasonable of costs.

If the Commission defines and controls the major ratemaking issues, it can easily prevent "gaming" of the system. Continental recommends that the Commission require that cost of service showings demonstrate an allocation of costs among regulated tiers and an overall return from regulated services. This will preclude artificially inflated returns on the cost of service tier, while avoiding the costs, delays, and jurisdictional disputes attendant to redundant cost of service showings on multiple tiers.

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**REPLY COMMENTS OF CONTINENTAL CABLEVISION, INC.  
ON THE THIRD NOTICE OF PROPOSED RULEMAKING**

Continental Cablevision, Inc. ("Continental") respectfully replies to the Comments filed in this matter on September 30, 1993.

**I. THE COMMENTERS GENERALLY SUPPORT THE COMMISSION'S PREFERRED APPROACH REGARDING CHANNEL ADDITIONS, WITH MODIFICATIONS SIMILAR TO THOSE PROPOSED BY CONTINENTAL.**

In its initial Comments, Continental recommended that the Commission adopt its proposed formula for adjusting rates in the wake of additions or deletions of channels, modified in certain respects.<sup>1</sup> The Comments reveal widespread support for the adoption of some form of this approach, not only among cable

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<sup>1</sup> Comments of Continental Cablevision, Inc. on the Third Notice of Proposed Rulemaking ("Continental Comments"), Section III.

operators,<sup>2</sup> but among program suppliers<sup>3</sup> and franchising authorities as well.<sup>4</sup>

There is also significant support in the Comments for Continental's suggestion that rate changes caused by the addition or deletion of channels from a tier should be limited to that tier. The Commenters concur that such modification is needed both to avoid basic tier rate increases in response to the addition of fee-based programming on a cable programming service tier and to accommodate the fact that cable programming service tiers often have less than total penetration among subscribers.<sup>5</sup> Based on this record, therefore, Continental requests that the

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<sup>2</sup> See, e.g., Comments of Joint Parties [on behalf of Cablevision, et al.] ("Cablevision Comments"), Section I.

<sup>3</sup> See, e.g., Comments of the Disney Channel in Response to Third Notice of Proposed Rulemaking ("Disney Comments") at 5-7; Comments of Discovery Communications, Inc. ("Discovery Comments") at 8-11.

<sup>4</sup> See, e.g., Comments on Third Further Notice of Proposed Rulemaking by Austin, Texas; Dayton, Ohio; Dubuque, Iowa; Gillette, Wyoming; King County, Washington; Montgomery County, Maryland; the City of St. Louis, Missouri; and Wadsworth, Ohio ("Miller & Holbrooke Comments") at 8-9; Comments of the New York State Commission on Cable Television ("NYSCCT Comments") at 1-3. The general consensus belies the claim by the National Association of Telecommunications Officers and Advisors, et al., that the Commission's proposal is too complicated. See Comments of the National Association of Telecommunications Officers and Advisors, the National League of Cities, the United States Conference of Mayors, and the National Association of Counties in Response to the Third Notice of Proposed Rulemaking ("NATOA Comments") at 14-16. NATOA's suggested alternative, involving pure benchmark rates, adjusted to reflect past external cost changes and other factors, is significantly more complex than the Commission's proposal, even with the modifications suggested by Continental and others.

<sup>5</sup> See, e.g., Comments in Response to the Third Notice of Proposed Rulemaking [on behalf of Falcon Cable TV, et al.] ("Falcon Comments") at 2, 4-6.

Commission approve this modification to the initially proposed formula.

Continental's Comments also noted (p. 12) that even with the one adjustment, the internal benchmark margin may not be sufficient to encourage investment in and carriage of new programming services. Other Commenters suggest that the Commission's proposal be further modified to reflect a reasonable margin on programming costs when channels are added or deleted.<sup>6</sup> As Cablevision suggests, this could easily be accomplished by applying the same reasonable "margin" allowance both to the old actual programming costs being "backed out" of the formula and to the new actual programming costs being added back in. Cablevision Comments at 9-11. Continental supports this proposal.

Some franchising authorities argue that when the new channel has been added in exchange for obtaining a broadcaster's retransmission consent, operators should not be allowed to increase revenues, even when per-channel rates decrease as called for by the benchmark formula. Allowing operators to charge for the new channel, they claim, would be the same as the operator paying a retransmission fee and including those costs in subscriber rates, a result presently barred by the Commission's rules.<sup>7</sup>

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<sup>6</sup> See, e.g., Disney Comments at 5-7; Cablevision Comments at 9-11.

<sup>7</sup> Miller & Holbrooke Comments at 8-9.

The Commission should reject this argument. When a channel is added as part of an agreement with a broadcaster, subscribers actually receive more programming, for which it is reasonable and appropriate to charge them. They are not paying more to receive the same channels.

If the Commission were to deny a system cost recovery for a new service solely because it is commonly owned with a broadcaster which the system is also carrying, it would face unsurmountable practical difficulties. Would the Commission permit the system to recover costs for Nickelodeon, MTV, and VH-1 if the system also carries a Viacom-owned broadcast station. Would the Commission distinguish between ESPN and ESPN2 if the system also carries an ABC owned and operated station? Would it allow recovery of costs for continued carriage of News Channel 8 by Washington area operators now that WJLA has granted retransmission consent? The Commission is in danger of entering a quagmire of judgments about the value of particular programs based on accidents of affiliation.

Denying cost recovery for services like ESPN2 and FX cannot square with the statutory and constitutional proscriptions on such editorial judgments which the Commission has long and wisely eschewed. For these reasons, the Commission should treat channels added in connection with retransmission consent exactly as it treats any other channel addition.

## **II. THE COMMISSION SHOULD ALLOW STREAMLINED AND EXTERNAL RECOVERY OF UPGRADE COSTS.**

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A number of Commenters go to great lengths arguing against any recovery of system upgrade costs, regardless of the benefits such upgrades bring to subscribers. They assert that the benchmarks already contain sufficient compensation;<sup>8</sup> or that they might be used to provide benefits to only "a few" subscribers;<sup>9</sup> that there is too great a risk of cross-subsidizing PCS or other nonregulated services if upgrade costs are to be recovered;<sup>10</sup> that streamlined recovery will be overwhelmed by complexity;<sup>11</sup> and that upgrades required by franchise, if given external treatment, will unfairly "punish" the vigilant local franchisor and discriminate in favor of the

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<sup>8</sup> See, e.g., Miller & Holbrooke Comments, Section I.A. and Exhibit A ("Smith Report") at 2-4. The Smith Report appears to be arguing that (a) the benchmarks reflect economies of scale; (b) Mr. Smith's review of certain actual upgrades also reflects economies of scale; and, therefore (c) the benchmarks provide sufficient compensation for upgrade costs. See id. Continental's initial Comments illustrate the fallacy in Mr. Smith's reasoning: while upgrades may well result in economies of scale, those economies are not always as great as the "economies" implicit in the benchmark formula. See Continental Comments, Exhibit A. As a result, unless an "upgrade adjustment" is included, as Continental has proposed, the Commission will inadvertently create a strong disincentive for cable operators to upgrade their systems.

<sup>9</sup> See NATOA Comments at 6-7.

<sup>10</sup> Id. at 9-10.

<sup>11</sup> Id. at 7 n.3.

negligent community which left upgrades to the operator's judgment.<sup>12</sup>

Continental's Comments have already demonstrated the falsity of these claims. Even franchising authorities recognize that most system upgrades result in a number of benefits for all subscribers, including clearer signals, reduced system outages, and greater channel capacity.<sup>13</sup> The straightforward upgrade cost formula shown in Continental's Comments presents a simple demonstration of three critical principles. (1) The benchmark system does not provide compensatory returns for even the most basic of upgrades from 450 to 550 MHz. (2) The investment required to upgrade the system will produce discernable benefits to all customers, in the form of added channel capacity and better signal quality. (3) The upgrade investment may be fairly allocated between regulated and nonregulated services through objective criteria--activated channels.

Nor does recovery of upgrade costs amount to an opportunity to "punish" the vigilant local franchisor: the same formula which provides for streamlined recovery of system upgrade costs may also be used to recover the costs of upgrade requirements imposed by franchise. Additionally, Continental proposed to limit the streamlined recovery of costs to upgrades which would not exceed the pre-upgrade per-channel, per subscriber cost.<sup>14</sup> The

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<sup>12</sup> Miller & Holbrooke Comments at 2.

<sup>13</sup> Miller & Holbrooke Comments, Exhibit A (Smith Report) at 2.

<sup>14</sup> Continental Comments at 17.

straightforward proposal submitted by Continental moots all of the concerns raised by franchising authorities, and should be welcomed by the Commission.

NATOA also suggests that "[u]pgrades that are required in order to meet federal requirements should not have an impact on rates."<sup>15</sup> To the extent that a cable operator incurs costs in connection with meeting regulatory requirements, however, the operator is entitled to recover those costs, through a cost of service showing if through no other means. The only question here is whether the Commission can reasonably lower administrative burdens on operators and regulators alike by allowing upgrade costs to be recovered, at least in part, on a streamlined basis. The mechanism proposed by Continental meets this objective.

NATOA also expresses concern that cable operators may upgrade their systems in a way that benefits only a few subscribers, and suggests that no streamlined cost recovery should therefore be permitted. Yet NATOA presents no factual evidence to support its concern. In any event, the fact that some new channel capacity might be used for unregulated services is not a reason for the Commission to abandon a streamlined approach to recovering upgrade costs. To the contrary, this simply confirms the point, made in Continental's initial Comments, that the Commission should prescribe clear rules governing the allocation of system costs as between regulated and

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<sup>15</sup> NATOA Comments at 4 n.1.

unregulated services and among tiers of regulated services. With clear cost allocation rules in place, the only upgrade costs that would ever be included in a regulated "upgrade charge" are those fairly attributable to regulated operations.<sup>16</sup>

Continental's proposal fairly and reasonably addresses the objections raised by franchising authorities without forcing cable operators to the Hobson's choice of an elaborate cost-of-service proceeding or deferral of system upgrades that would benefit its subscribers. It also responds to franchising authorities' concerns that rate regulation procedures may be overly complex and burdensome.

**III. THE COMMISSION SHOULD NOT DEFER TO LOCAL FRANCHISING  
AUTHORITIES ON ISSUES OF RATEMAKING POLICY.**

Representatives of local franchising authorities propose a variety of complex schemes under which the FCC's authority and responsibility to shape the national policy of rate regulation would be eviscerated. The schemes invite nimble franchising authorities to race to judgment on the first rate case and to adopt rate policies which they could not persuade the Commission to adopt in rulemaking.

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<sup>16</sup> In Continental's initial comments, it was assumed that the costs of an upgrade would be allocated between regulated and unregulated services based on the number of activated equivalent channels for each type of service. See Continental Comments, Exhibit A, line 8. As Continental has elsewhere stated, allocations may also be made on a weighted subscriber-channel basis and on other bases. See Comments of Continental Cablevision in MM Docket 93-215, August 25, 1993 at 80.

For example, in opposing streamlined recovery of required upgrade costs, NATOA goes so far as to suggest that revenues from unregulated services be considered in determining whether regulated rates should be increased to cover the costs of a system upgrade. Continental recognizes that regulators have an interest in assuring themselves that a system operator's costs have been properly allocated as between regulated and unregulated operations, and has urged the Commission to make binding rulings on cost allocation issues. Once an appropriate share of costs has been allocated to unregulated services, however, the only costs that remain are, by definition, fairly attributable to regulated services. As a result, Continental submits that -- once such cost allocations have been made -- it would be completely inappropriate to consider revenues from unregulated services in setting regulated rates.

Indeed, the Cable Act carries forward a long tradition of leaving premium television and other ancillary services to the unregulated market. The Act grants only limited authority to regulate rates for certain services, and was specifically amended in Conference to preclude reference to premium revenues when evaluating regulated tiers. See, e.g., 47 U.S.C. §553(c)(2)(D). It would be utterly inconsistent with the limited regulatory power granted to local franchising authorities by the Act to allow those authorities to consider revenues from services outside the scope of the statute in setting rates for services within it. Yet their proposals for Commission deference to local governments invites precisely that result.

As Continental explained in its initial Comments, it is the Commission that has the breadth of vision and depth of experience needed to decide issues of ratemaking policy, while local franchising authorities do not. In fact, the Comments of franchising authorities reflect their traditional role as tough negotiators for franchise concessions, whereas ratemaking requires impartial adjudicators to balance the various customer, cable, and public policy concerns. Even local franchising authorities recognize that, ultimately, this Commission is the final arbiter of cable television ratemaking policy. For example, NATOA suggests that if the Commission and local authorities routinely reach differing ratemaking results on the basis of similar factual records, the Commission should initiate a rulemaking to resolve the conflict.

Continental submits that this is that rulemaking. The alternative, as even franchising authorities recognize, is to wait for a series of balkanized local rulings to be made, and then conduct further rulemaking proceedings to fix the problem. It is far preferable for the Commission to specify how key issues of ratemaking policy will be resolved now -- before the process of rate regulation gets underway in earnest. For this reason, the Commission should not defer to local ratemaking decisions in any respect and should, to the contrary, adopt binding rules on all important issues of ratemaking policy to guide local rate decisions.

**IV. THE COMMISSION SHOULD NOT RESTRICT OPERATORS' ABILITY TO PURSUE COST-OF-SERVICE SHOWINGS ON THE BASIS OF HAVING RELIED ON THE BENCHMARKS FOR OTHER SERVICE TIERS.**

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Continental submits that once the Commission defines and controls the major ratemaking issues, no basis will remain for the concerns expressed by some commenters about operators "gaming" the regulatory process with selective cost of service showings. As noted in Continental's initial Comments, the Commission can and should resolve the entire concern about "gaming" by prescribing binding rules governing the allocation of costs among tiers and reviewing the overall return for both basic and cable programming service in proceedings before the Commission.<sup>17</sup>

With such rules in place, any cost-of-service filing for a particular tier would show overall system costs and the amount of those costs allocated to the affected tier. Any attempt at "gaming," therefore, would be readily detected and corrected. Indeed, Continental has invited a requirement that a presentation showing overall costs and the effects of the cost allocation system be made in any FCC cost-of-service showing. The Commission would then have full ability to protect against "gaming" the system. If, as some fear, low cost programming were moved to benchmark basic service, and high cost programming moved to the cable programming service (CPS) tier, the cost of service submission would clearly demonstrate the allocation of those costs and the overall return from regulated services, and thereby

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<sup>17</sup> Continental Comments at 3-5.

prevent artificially inflated returns. There would be no need for a redundant cost-of-service case before another jurisdiction, nor for the administrative costs, delays, and quandries over local versus federal deference which such parallel filings would invite.

In these circumstances, there is no reason for the Commission to prevent operators from relying on benchmark regulation for one tier and cost-of-service regulation for other tiers.

### **Conclusion**

For the foregoing reasons, Continental submits that (a) the Commission should permit cable operators to justify rates on any regulated tier using the cost-of-service methodology without regard to the methodologies used on other regulated tiers, subject to Commission review of allocations and overall return; (b) the Commission should make binding determinations on all significant ratemaking policy issues affecting regulated cable rates, and preempt decisions by local franchising authorities that do not conform to federal guidelines; (c) the Commission should adopt Continental's modified methodology for calculating the impact, under the benchmark approach, of changes in the number of channels offered on regulated tiers and streamlined recovery of the costs of channel capacity upgrades; and (d) the Commission should allow cable operators to treat system upgrades as "external costs."

Respectfully submitted,

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